52.44
1AR
002

2002 Annual Report

Lottery
Montana

STATE DOCUMENTS COLLECTION
JAN 27 2003
MONTANA STATE LIBRARY
1515 E. 6TH AVE.
HELENA, MONTANA 59620

MONTANA STATE LIBRARY
3 0864 1001 7550 7

Commissioners' Report

June 2002 marks the 15th anniversary of the Montana Lottery. The past 15 years have been rewarding and productive for the Lottery Commission, staff and Director.

The current Commission joined a dedicated and talented team of 32 individuals who have successfully developed this organization over the last 15 years. Ten of those individuals have more than ten years of continuous service to the Lottery, and of those 10, six have worked for the Lottery since 1987. The longevity is commendable, and a confirmation of the dedication our staff has for this organization.

Since 1987, we have returned $99 million to the various important state programs, paid out more than $213 million in prizes, and paid our retail partners over $24 million. That's over $235 million in direct benefits. Secondary economic benefits to the State of Montana include purchase of goods and services, community sponsorships, contracts with vendors, and salaries to employees.

Our Director and staff manage to hold the line on expenses, while continuing to meet the challenges of an ever-changing business environment with introductions of new products. On this our 15th anniversary, the Lottery Commission thanks our players, our retailers, and the citizens of Montana for continuing to support our efforts.

We look forward to a continued profitable and positive relationship with the people of Montana.

Sincerely,

Robert L. Crippen, Chair
Montana Lottery Commission

Left to Right
Standing - Cliff Brophy, Columbus; Bob Lake, Hamilton
Seated- Tom Keegan, Helena; Betty Wilkins, Missoula; Bob Crippen, Butte

Director's Message

Jerry LaChere, Director

I'm pleased to present our Fiscal Year 2002 Annual Report. This year, we exceeded our transfer expectations with a 21.5% increase over last fiscal year. This transfer goes the State of Montana General Fund on a quarterly basis.

Some increases are because of one-time accounting entries and large Powerball and Montana Cash jackpots. However, part of the transfer is a result of the diligence of our staff in keeping operating expenses in line with previous years, and the emphasis we have placed in continuing to keep our products fresh and new in the market.

Our retail network, which is so important to our success, remains supportive and encouraging. The Montana Lottery prides itself on working closely with our retail partners. Lottery products are found in communities across the state, in grocery stores, convenience stores, and a variety of other types of businesses. Retailers receive a commission for each ticket they sell, and in fiscal year 2002, commissions to retailers totaled nearly $2 million.

Our Lottery Commission, consisting of five residents of Montana, is to be commended as well for their leadership and support. They continue to offer suggestions and support business decisions made, with the purpose of assisting the staff in meeting our mandate of maximizing net revenue to the State.

Montanans have come to expect advancements in technology, games and integrity. Since my initial appointment to this position over six years ago, the staff and I have made significant steps in securing the future of this organization, and in laying a foundation for a solid future. In addition, we keep our fingers on the pulse of the public of Montana, by using market research, changing games and fine-tuning our in-house and out-of-house operations.

We continue to operate our business in responsible ways, looking to the future so we can maximize revenue for use by important state programs.

Sincerely,

Gerald J. LaChere

Gerald J. LaChere
Director

Transfers Increasing

The chart below illustrates the past three fiscal years, highlighting the Lottery's 21.5 percent increase in transfers this past fiscal year to the State of Montana General Fund.

Transfers are the profit of the Montana Lottery, which, by law, are transferred quarterly to the General Fund. The General Fund provides money to state programs which do not have a dedicated revenue source.

Fiscal year 2000	$5.8 million
Fiscal year 2001	$6.1 million
Fiscal year 2002	$7.5 million

Revenue includes ticket sales, earnings on investments, and miscellaneous income.

Fiscal year 2000	$30.3 million
Fiscal year 2001	$30.7 million
Fiscal year 2002	$33.8 million

Prizes, by law, are a minimum of 45 percent of all ticket sales revenue. Each of the three fiscal years show a recorded prize expense of approximately 51 percent.

Fiscal year 2000	$15.6 million
Fiscal year 2001	$15.7 million
Fiscal year 2002	$17.1 million

Expenses include personnel costs, advertising, rent and utilities, on-line system loan interest, amortization and depreciation, and supplies and materials.

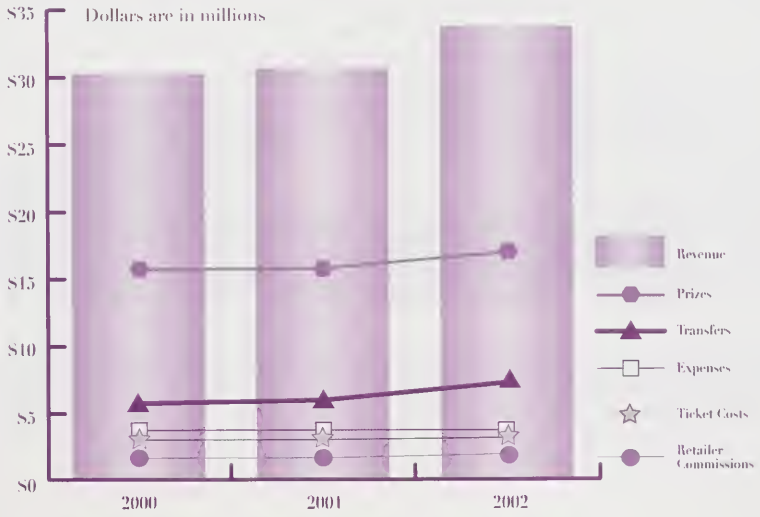
Fiscal year 2000	$4.0 million
Fiscal year 2001	$3.9 million
Fiscal year 2002	$4.0 million

Ticket Costs include the fee paid to the Lottery's on-line vendor for expenses related to the operation and maintenance of the system which sells Lotto tickets and accounts for all Lottery products, and the cost of printing Scratch tickets. Ticket costs rise proportionate to ticket sales.

Fiscal year 2000	$3.1 million
Fiscal year 2001	$3.2 million
Fiscal year 2002	$3.5 million

Retailer Commissions are mandated by the Lottery law. Retailers get a minimum of 5% of each ticket sold with the potential of up to 10% on Scratch tickets.

Fiscal year 2000	$1.7 million
Fiscal year 2001	$1.7 million
Fiscal year 2002	$2.0 million



Product Highlights

The Montana Lottery's sales strategy is to offer a variety of games in both product areas, Scratch and Lotto, and to responsibly market the products we offer. Our goal is to maximize revenue for the State of Montana.

The addition of *Hot Lotto* in fiscal year 2002 rounds out the variety of different Lotto games available in Montana. The minimum jackpots range from $20,000 for *Montana Cash* to $10 million for *Powerball*, with *Wild Card* at a minimum jackpot of $100,000 and *Hot Lotto* with a $1 million minimum jackpot prize.

The Scratch product line was enhanced with the addition of a $5 game, which can offer a larger top prize, typically in the $50,000 range. *Crossword* and *Bingo* games remain consistant sellers, and the $1 tickets offer a variety of play styles, prizes, features and graphics. Top prizes in Scratch games range from $50 to $50,000.

The Montana Lottery offers a variety of Scratch games that are introduced each year. At any one time, the Lottery offers approximately 14 different Scratch games. The games appeal to a variety of players, and each has a unique design, play style, and prize structure. Scratch games can be purchased for $1, $2, $3 or $5.

The Lottery continues to introduce new and interesting play styles to keep the products fresh and exciting. Scratch sales totaled $9,774,100 in fiscal year 2002, a 9 percent increase over fiscal year 2001, and the highest Scratch sales since fiscal year 1990. Prize expense totaled $5.6 million, or 57.7% of sales.

In fiscal year 2002, 29 different games were introduced, including a $5 ticket, *Easy Street*, which went on sale in October 2001. The introduction of a $5 price point ticket garnered $700,000 in Scratch ticket revenue for the fiscal year. The Montana Lottery believes that by continuing to offer a variety of tickets with varying prices, Scratch ticket revenue will grow slightly during fiscal year 2003. A new type of game called *Slingo*® will be introduced in fiscal year 2003. The game will sell for $3 and is patterned after *Bingo*.

Introduced in 1992 and revamped in November 1997, *Powerball* is the most popular game played in Montana. Players select five numbers from a field of 49 plus the Powerball from a field of 42. Top prize in the game is a growing jackpot, starting at the minimum of $10 million. *Powerball* sales were $15.7 million in fiscal year 2002. Prize expense totaled $7.5 million, or 47.4% of sales.

Power Play

On March 1, 2001, *Power Play*, a feature available to players for an additional $1 per play, was introduced. The purchase of the *Power Play* option gives winners of prizes, except the jackpot, a chance to multiply their winnings. *Power Play* sales in Montana contributed approximately four percent of Powerball revenue in fiscal year 2002.

In October 2002, a change to the *Powerball* game will be introduced. Four additional white balls will be added to the matrix, which will increase the odds of winning the jackpot to one in 120 million. The overall odds of winning a prize will remain essentially the same, at 1 in 36 compared to 1 in 35. The *Power Play* matrix will also change, so that a player who purchases the *Power Play* option and wins will receive a multiplied payout. Previously, the number "1" was included on the *Power Play* wheel, and when drawn, prizes did not multiply.

MONTANA CA$H

Introduced in 1994, *Montana Cash* is the Lotto game that offers the best odds of winning the jackpot. Players select five numbers from a field of 37, and receive two plays for $1. If players match three, four or five of five numbers, they win a prize. Top prize in the game is a growing jackpot, starting at $20,000. *Montana Cash* sales were $4.4 million in fiscal year 2002. Prize expense totaled $2.3 million, or 52.3% of sales.

WILD CARD 2

Introduced in February 1998, *Wild Card* is offered by Montana, Idaho and South Dakota. Players select five numbers from a field of 34, plus a Wild Card from Jack through Ace of the four card suits. If players match the Wild Card or three, four or five of five numbers drawn, they win a prize. If players match the Wild Card in addition to any of the numbers, their prize increases. Top prize in the game is a minimum $100,000 growing jackpot. *Wild Card* sales were almost $2.6 million in fiscal year 2002. Prize expense totaled $1.3 million, or 51.9% of sales.

Hot Lotto™ MONTANA

The Lottery's newest Lotto game was introduced in April 2002 in conjunction with five other lottery jurisdictions. *Hot Lotto* offers a minimum $1 million growing jackpot and eight other prize levels from $10,000 to $2. Players select five numbers from a field of 39, plus the Hot Ball from a field of 19 numbers. *Hot Lotto* sales were $620,342 in fiscal year 2002, in its first three months of sales. Prize expense totaled $305,963, or 49.3% of sales.

The *Rolldown* game ended April 6 and was replaced by *Hot Lotto*. Sales were $509,038. Prize expense totaled $236,604, or 46.5% of sales.

Winners

Montana Lottery
For the *fun* of it!

Over 1.8 million winning tickets were sold to Montana Lottery players in fiscal year 2002. Prize expense totaled $17.1 million bringing total prizes since 1987 to over $213 million.

Winners claimed prizes from every corner of Montana, from a $10,000 *Blue Line Bingo* ticket in Brockton in northeastern Montana, to a $5,000 *Wild Card* ticket sold in Dillon. A $10,000 *Hot Lotto* ticket was sold in Eureka, and a $50,000 *Easy Street* ticket was sold in Broadus.

Significant wins in fiscal year 2002:

- The largest prize paid in fiscal year 2002 was $187,428, to a winner claiming a *Wild Card* jackpot in September 2001. This was also the largest *Wild Card* prize paid this fiscal year. A second *Wild Card* jackpot, $160,000, was sold in February 2002 in West Yellowstone.

- The largest *Powerball* prize paid in fiscal year 2002 was $100,000, paid thirteen times this fiscal year.

- The largest *Montana Cash* prize paid in fiscal year 2002 was $170,000 in July, 2001, sold to a single ticket-holder in Billings. In December, a ticket sold in Billings shared a $270,000 *Montana Cash* jackpot with a ticket-holder from Livingston, and each winner received $135,000.

- The largest *Scratch* prize paid in fiscal year 2002 was a $50,000 *Easy Street* prize, sold in Broadus.

- The largest *Hot Lotto* prize paid in fiscal year 2002 was $10,000. There was a $10,000 *Hot Lotto* ticket sold for both the June 1 and June 5, 2002 drawings.

- The largest *Rolldown* prize paid in fiscal year 2002 was $3,991, sold in August 2001. *Rolldown* ended in April 2002.

Independent Auditors' Report

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 2002 and 2001. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and non-expendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note P to the basic financial statements, the Lottery adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*; Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*; and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as of July 1, 2001. This results in a change in the format and content of the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 4, 2002 on our consideration of the Montana State Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management Discussion and Analysis on pages 8 through 10 are not a required part of the basic financial statements but are supplementary information recommended by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Galusha, Higgins & Galusha, PC

GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors
Helena, Montana

October 4, 2002

Management Discussion and Analysis

The following *Management Discussion and Analysis* (MD&A) of the Montana State Lottery's (Lottery) activities and financial performance provides the reader with an introduction to and overview of the financial statements for the fiscal year ended June 30, 2002. This discussion is an element of the new reporting model adopted by the Government Accounting Standards Bureau (GASB) Statement No. 34. In this first year using the new reporting model, certain information will not be comparable with the previous year but will be in succeeding years. We encourage readers to consider this information in conjunction with the financial statements, which directly follow.

REQUIRED FINANCIAL STATEMENTS

The Lottery is classified as a special-purpose government fund engaged only in business-type activities. Accordingly, the Lottery operates in much the same manner as commercial enterprises using the full accrual method of accounting. The basic financial statements consist of two components:

1) Fund Financial Statements: a *Statement of Net Assets*, a *Statement of Revenues, Expenses, and Changes in Fund Net Assets*, and a *Statement of Cash Flows*; and

2) Notes to the Financial Statements.

The *Statement of Net Assets*, previously called the Balance Sheet, includes both short-term and long-term assets and liabilities, and capital assets are capitalized and depreciated over their useful lives. Because the Lottery is required to transfer all "profits," or the excess of assets over liabilities, to the State's General Fund, its "net assets" will always be zero.

The *Statement of Revenues, Expenses, and Changes in Fund Net Assets*, previously referred to as the Income Statement, includes all of the current year's revenues and expenses. Revenues are recognized when earned, not when received, and expenses are recognized when incurred, not when paid. This statement measures the success of the Lottery's operations over the past year and details the total amount transferred to the General Fund.

The final statement is the *Statement of Cash Flows*. The primary purpose is to provide information about the cash receipts and payments, and changes in cash resulting from operations, investing and financial activities.

NET ASSETS

The table below presents a summary of the Lottery's *Statement of Net Assets*.

Condensed Statements of Net Assets
As of June 30, 2002 and June 30, 2001

	FY 2002	(Restated for MD&A Purposes Only) FY 2001	Change
Current Assets	$ 2,015,564	$ 3,279,848	$ (1,264,284)
Capital Assets (Net of Depreciation)	3,977,175	4,040,064	(62,889)
Other Assets	2,100,876	2,265,496	(164,620)
Total Assets	$8,093,615	$9,585,408	$ (1,491,793)
Current Liabilities	$5,209,339	$ 5,111,815	$ 97,524
Long-Term Liabilities	2,884,276	4,235,910	(1,351,634)
Total Liabilities	$8,093,615	$9,347,725	$ (1,254,110)
Invested in Capital Assets, Net of Related Debt	$ 1,812,553	$ 872,976	$ 939,577
Unrestricted Net Assets	(1,812,553)	(872,976)	(939,577)
Contributed Capital	0	237,683	(237,683)
TOTAL NET ASSETS	$ 0	$ 237,683	$ (237,683)

The largest change in the Lottery's assets is a result of purchasing lotto terminals. The terminals are placed at retail locations and are the outlets through which all lotto game tickets are sold. It is expected that additional full-service retail outlets will augment the Lottery's sales and resulting transfer to the General Fund.

The major change in liabilities is the result of payments made on the Lottery's long-term loan. Additional information on this debt is contained in the debt analysis section.

The difference between assets and liabilities is "Net Assets." Under GASB 34, net assets is comprised of three components - *Invested in Capital Assets, net of related debt; Restricted Net Assets*; and *Unrestricted Net Assets*. The component, Invested in Capital Assets, consists of capital assets, net of accumulated depreciation and reduced by the outstanding balance of the related debt. In this case, it demonstrates that the Lottery is paying off its long-term note faster than it is depreciating the equipment and software purchased with the proceeds of the note. The Lottery does not have any Restricted Net Assets and Unrestricted Net Assets consist of the Total Net Assets less the other two components. Since the Lottery's total Net Assets equals $0, the Unrestricted Net Assets must be a negative amount equal to the amount invested in capital assets. The Contributed Capital listed in FY 2001 was equipment received from a vendor in 1994; GASB 34 requires the elimination of contributed capital and this value was included in the FY 2002 transfer to the General Fund.

OPERATIONS AND CHANGES IN NET ASSETS

The table below presents a summary of the Lottery's Operations for the last two years.

Condensed Statements of Revenues, Expenses & Changes in Net Assets
For the Years Ended June 30, 2002 and 2001

	FY 2002	FY 2001	Change
Operating revenues	$ 33,670,324	$30,423,126	$3,247,198
Ticket Expenses	22,560,072	20,637,936	1,922,136
Net Operating Revenue	$11,110,252	$9,785,190	$1,325,062
Operating Expenses	3,890,552	3,728,692	161,860
Net Operating Income	$ 7,219,700	$6,056,498	$1,163,202
Non-Operating Income/Expenses	9,647	88,178	(78,531)
Income Before Operating Transfer	$ 7,229,347	$6,144,676	$1,084,671
Change in Accounting Principle	237,683	-	237,683
Transfer to General Fund	$ (7,467,030)	$ (6,144,676)	$ (1,322,354)
Change in Net Assets	$ 0	$ 0	$ 0

Due to record high jackpots in *Powerball* in September and *Montana Cash* in December, the Lottery experienced a 10.6% increase in sales for fiscal year 2002. Ticket expenses, which are directly related to sales, had a similar increase. However, ticket expense was somewhat reduced by one-time expense abatements. A reserve of $187,948, held for *Cash 4 Life*, was returned after the game was discontinued; and the Lottery also received a refund of $2,987 as its portion of an unclaimed *Rolldown* jackpot.

Operating expenses remained steady, except for an increase in depreciation due to additional equipment purchased in mid-year of FY 2001.

The income from non-operating activities was less than the previous year. This category includes interest received from investments and interest paid on the long-term loan. The reduction was a result of fewer funds invested, because of equipment purchases, and also lower returns on the investments.

The increase in sales, one-time ticket expense abatements and change in accounting principle coupled with unchanged expenses resulted in a substantially increased transfer to the General Fund, 21.5% more than the previous year.

Management Discussion and Analysis Continued

CAPITAL ASSETS AND DEBT ADMINISTRATION

The Lottery follows the State's policy of capitalizing fixed assets with an historical value of $5,000 or more. The Lottery holds two main types of fixed assets: 1) a fleet of vehicles used by the sales staff and 2) the Games Management System (GMS), which tracks and controls the sale of all Lottery products, validation of winning tickets, and payments to winners. GMS consists of centralized computer equipment and operating software located in Helena and includes all of the terminals, both for instant and lotto games, located at retail locations.

Fixed assets are depreciated using the straight-line method over the appropriate estimated useful life, ranging from three to seven years.

In FY 2002, fixed asset purchases consisted of 165 lotto terminals at a total cost of $759,000, replacement central computer equipment at a cost of $28,520, and a replacement vehicle for $20,215.

In 1999, the Lottery entered into a loan agreement with Norwest Investment Services to purchase the Games Management System. The 5-year loan was for $5,025,311 at 5.12% interest and payments are made quarterly. At the end of FY 2002, the outstanding principal amount is $2,164,622, a reduction of $1,002,466 from the previous year. The Lottery has no other debt-related commitments.

LOOKING AHEAD

One of the Lottery's goals is to maximize revenue for the State's programs. This requires offering games that Lottery players want to play, providing convenient locations for the purchase, and controlling operating expenses. To help achieve its goals, the Lottery will be conducting market research to determine the needs of the playing public.

Dramatic increases in lotto revenues are usually the result of higher jackpots; however, such jackpots cannot be predicted nor counted upon. Instead, the Lottery continues to update and change its product mix. In April 2002, the Lottery launched a new multi-state game called *Hot Lotto*. The game's sales started strong and are expected to remain so, especially as players and retailers become familiar with the game and as jackpots increase.

Another multi-state game in which Montana participates is *Powerball*. In October 2002, this game will be undergoing changes to refurbish the game and develop new interest. As a result, the Lottery expects *Powerball* to remain a profitable and desirable game.

The Lottery will introduce a new type of instant scratch game in late 2002. The *Slingo'* game is a scratch version of a game that has been played on the Internet and has been very successful for other lotteries.

In addition, the Lottery purchased terminals to be able to increase the number of retail outlets throughout the state. These terminals will be placed over the first two quarters of fiscal year 2003 and the Lottery expects increased revenue as a result.

Omitting the possibility of a record jackpot, the Lottery projects that the transfer to the General Fund in FY 2003 will be approximately $6.8 million.

CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Lottery's finances for all of Montana's citizens, taxpayers, players, investors and creditors, and to report on the Lottery's accountability for its funds. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

Montana Lottery, 2525 N. Montana Avenue, Helena, MT 59601.

Statements of Net Assets

June 30,

ASSETS	2002	2001
CURRENT ASSETS		
Cash and cash equivalents	391,199	1,216,236
Accounts receivable, net of allowance	796,271	898,301
Due from other funds	2,645	1,955
Inventory	812,944	1,151,747
Other current assets	12,505	11,609
Total current assets	2,015,564	3,279,848
FURNITURE AND EQUIPMENT		
Furniture, fixtures and equipment	5,562,699	4,769,593
Accumulated depreciation	(2,208,177)	(1,514,826)
	3,354,522	3,254,767
INTANGIBLE ASSETS		
Software, net of accumulated amortization	616,071	780,357
Other intangibles	6,582	4,940
	622,653	785,297
OTHER ASSETS		
MUSL Prize Reserve fund	2,100,876	2,265,496
TOTAL ASSETS	8,093,615	9,585,408

LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	1,015,848	496,198
Accrued interest payable	20,011	29,278
Estimated prize liability	1,336,547	1,534,740
Transfer obligations to general fund	1,591,454	1,901,484
Due to other state agencies	10,448	88,485
Deferred on-line revenue	78,821	59,164
Current portion of compensated absences	101,424	-
Current portion of long term debt	1,054,786	1,002,466
Total current liabilities	5,209,339	5,111,815
LONG-TERM LIABILITIES		
MUSL prize liability	1,707,049	1,898,011
Note payable	1,109,836	2,164,622
Accrued compensated absences	67,391	173,277
	2,884,276	4,235,910
TOTAL LIABILITIES	8,093,615	9,347,725
COMMITMENTS AND CONTINGENCIES		
NET ASSETS		
Invested in capital assets, net of related debt	1,812,553	-
Unrestricted net assets	(1,812,553)	-
Contributed capital	-	237,683
TOTAL NET ASSETS	-	237,683
TOTAL LIABILITIES AND NET ASSETS	8,093,615	9,585,408

The accompanying notes are an integral part of these financial statements.

Statements of Revenues, Expenses and Changes in Net Assets

For The Years Ended June 30,

	2002	2001
OPERATING REVENUES		
Instant ticket games	9,774,100	8,950,849
On-line games	23,858,173	21,415,677
Miscellaneous	38,051	56,600
Total Operating Revenues	33,670,324	30,423,126
COST OF TICKET REVENUES		
Instant ticket prize expense	5,643,263	5,295,632
On-line ticket prize expense	11,460,703	10,433,842
Retailer commission	1,982,254	1,732,572
On-line vendor fees	2,808,117	2,535,067
Cost of tickets sold	665,735	640,823
Total cost of ticket revenues	22,560,072	20,637,936
Net operating revenues	11,110,252	9,785,190
OPERATING EXPENSES		
Advertising	566,253	566,195
Communications	99,067	118,716
Advertising production	183,510	128,764
Audit fees	27,793	44,207
Contractual services	149,839	217,919
Depreciation and amortization	870,071	784,320
Management fees	70,888	123,926
Multi-state operating fees	76,426	49,614
Other	98,920	95,857
Personal services	1,260,507	1,260,377
Repairs and maintenance	22,226	35,918
Supplies and materials	336,859	179,462
Utilities and rent	99,775	98,494
Travel	28,418	24,923
Total operating expenses	3,890,552	3,728,692
OPERATING NET INCOME	7,219,700	6,056,498
NON-OPERATING REVENUES (EXPENSES)		
Interest income	145,599	275,304
Interest expense	(133,844)	(184,029)
Security lending income	825	616
Security lending costs	(739)	(599)
Loss on disposal of furniture and equipment	(2,194)	(3,114)
Total non-operating net income	9,647	88,178
INCOME BEFORE OPERATING TRANSFERS	7,229,347	6,144,676
OPERATING TRANSFERS OUT		
General Fund	7,467,030	6,144,676
Total operating transfers out	7,467,030	6,144,676
Change in net assets due to cumulative change in accounting principle	(237,683)	-
Net assets, beginning of year	237,683	237,683
Net assets, end of year	-	237,683

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

For The Years Ended June 30,

	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	33,800,214	30,109,214
Cash paid to suppliers for goods and services	(7,071,674)	(6,625,036)
Cash paid to employees	(1,315,780)	(1,276,115)
Cash paid for prizes	(17,305,122)	(15,305,456)
Net cash provided by operating activities	8,107,638	6,902,607
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
General fund	(7,784,243)	(5,749,110)
Net cash used by non-capital financing activities	(7,784,243)	(5,749,110)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(48,735)	(629,632)
Interest paid	(143,111)	(192,836)
Payments on long-term borrowing	(1,002,466)	(952,741)
Proceeds from sale of fixed assets	-	2,325
Net cash used by capital and related financing activities	(1,194,312)	(1,772,884)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and dividend income	45,794	86,720
Security lending income	825	616
Security lending costs	(739)	(599)
Net cash provided by investing activities	45,880	86,737
NET DECREASE IN CASH AND CASH EQUIVALENTS	(825,037)	532,650)
Cash and cash equivalents, beginning of year	1,216,236	7,748,886
Cash and cash equivalents, end of year	391,199	1,216,236
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	7,219,700	6,056,498
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	870,071	784,320
Changes in net assets and liabilities:		
(Increase) decrease in accounts receivable	102,030	(215,796)
(Increase) decrease in due from other state agencies	(690)	281
(Increase) decrease in inventory	338,803	(29,921)
(Increase) decrease in other current assets	(896)	14,475
(Increase) decrease in long-term receivable	164,620	(163,310)
Interest receivable included in long-term receivable	106,989	188,583
(Increase) decrease in other tangible assets	(1,642)	7,279
Increase (decrease) in accounts payable	(239,350)	128,240
Increase (decrease) in lottery prizes payable	(389,155)	469,070
Increase (decrease) in deferred revenue	19,657	(88,676)
Increase (decrease) in due to other state agencies	(78,037)	7,299
Increase (decrease) in compensated absences payable	(4,462)	745
Net cash provided by operating activities	8,107,638	6,902,607

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

June 30, 2002 and 2001

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana.

Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the type and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery was attached to the Montana Department of Commerce for administrative purposes through June 30, 2001. A Legislative organizational change effective July 1, 2001 transferred the Lottery to the Department of Administration.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund.

Reporting Entity - The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition - Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investments pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Allowance for Uncollectible Accounts - The Lottery uses the allowance method to account for uncollectible receivables. The allowance is based on management's estimate of possible bad debts.

Advertising Costs - Advertising costs are expensed as incurred.

Allowance for Returned Tickets - The Lottery's policy is to accept any unscratched instant ticket from a retailer for credit without regard to when the ticket or pack of tickets was activated. Therefore, an allowance to recognize the possibility of returns is calculated at the end of each fiscal year.

Inventory - Inventory consists of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes - Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Unclaimed Prizes - Prizes for the on-line games, *Powerball*, *Wild Card*, *Cash 4 Life* (discontinued in September 2000), *Rolldown* (discontinued in April 2002), *Hot Lotto*, and *Montana Cash*, must be claimed within six months after the appropriate draw date. Prizes for instant games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The combined amounts of unclaimed prizes for on-line games were $778,922 and $731,241 and for the instant games were $348,195 and $186,648 for the fiscal years ended June 30, 2002 and 2001, respectively.

Intangible Assets - Intangible assets consists of the following:

Software represents the unamortized cost of software purchased in 1999. This software had an original cost of $1,150,000 and is being amortized over seven years.

Other intangibles represents the per ticket cost paid to Scientific Games International (formerly known as Autotote Lottery Corporation) for advance on-line ticket sales. These ticket sales, recorded as deferred revenue, represent tickets sold prior to June 30, 2002 and 2001 for drawings held subsequent to fiscal year-end.

Furniture and equipment - Furniture and equipment are recorded at cost. Donated furniture and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of furniture and equipment, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years. The Lottery conforms to the State of Montana capitalization threshold for recording furniture and equipment. This threshold is $5,000.

Contributed Capital - Contributed capital represents equity acquired through contributions from vendors and the State of Montana. Under Governmental Accounting Standards Board Statement No. 34 contributed capital is not allowed and has been rolled into net assets as of June 30, 2002.

Compensated Absences - State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	June 30,	
	2002	2001
Short-term investment pool	$185,445	$1,069,565
Cash on deposit with State Treasurer	195,604	136,521
Cash in revolving deposit account	10,000	10,000
Petty cash	150	150
	$391,199	$1,216,236

The Lottery participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. There are no legal risks that the Board of Investments is aware of regarding any STIP investments. The bank balance of the revolving deposit account was $19,568 and $25,897 at June 30, 2002 and 2001, respectively, and was covered by federal depository insurance. The carrying amount reported in the Statement of Net Assets for cash and cash equivalents approximates the fair market value.

Notes to the Financial Statements Continued

NOTE C - ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

	June 30, 2002	2001
Accounts receivable	$992,715	$1,072,505
Allowance for uncollectible accounts	-	(5,900)
Allowance for returned tickets	(196,444)	(168,304)
	$796,271	$ 898,301

NOTE D - INVENTORY

Inventory consists of the following:

	June 30, 2002	2001
Instant scratch tickets	$699,250	$ 947,277
Supplies	113,694	204,470
	$812,944	$1,151,747

NOTE E - OTHER CURRENT ASSETS

Other current assets consist of the following:

	June 30, 2002	2001
Prepaid expenses	$ 7,475	$ 6,809
Employee travel advances	5,030	4,800
	$12,505	$11,609

NOTE F - FURNITURE AND EQUIPMENT

A summary of furniture and equipment for the Lottery is as follows:

	June 30, 2001	Additions	Deletions	June 30, 2002
Furniture, fixtures and equipment	$4,769,593	$807,735	$ (14,629)	$5,562,699
Accumulated depreciation	(1,514,826)	(705,785)	12,434	(2,208,177)
Total	$3,254,767	$101,950	$ (2,195)	$3,354,522

NOTE G - MULTI STATE LOTTERY ASSOCIATION - MUSL

Joint Venture Association - In November 1989, the Lottery joined the Multi-State Lottery Association - MUSL. MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The *Powerball* game, *Wild Card* game and *Hot Lotto* game are presently the only games operated jointly by the members in which the Lottery participates. The *Cash 4 Life* game was discontinued in September 2000, and *Rolldown* was discontinued in April 2002. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable Payable - As a member of MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of $2,100,876 and $2,265,496 at June 30, 2002 and 2001, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of $93,971,128 and $97,667,729 for 2002 and 2001, respectively. The long-term liability balance of $1,707,049 and $1,898,011 at June 30, 2002 and 2001, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments - Prizes awarded to *Lotto* America* grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 2002 and 2001, MUSL held United States Government zero coupon bonds in trust for the Lottery winners with respective par values of $55,165,949 and $60,373,949 and respective market values of $43,163,160 and $44,348,279.

The Lottery has eight *Lotto* America/Powerball/Tri-West* winners. The combined total future prize payments owed is $55,165,000 and $60,373,000, at June 30, 2002 and 2001, respectively. Total annual payments due over each of the next five years is $5,208,000 annually and $29,125,000 thereafter. The present value of future prize payments approximates the current market value of the bonds held in trust for the Lottery winners.

Multi-State Lottery Association Financial Position - Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	June 30, 2002	June 30, 2001
Total Assets	$1,294,979,136	$1,315,863,534
Total liabilities	1,294,673,721	1,315,536,546
Total net assets	305,415	326,988
Total liabilities and net assets, unrestricted	$1,294,979,136	$1,315,863,534
Total revenues	$ 6,604,958	$ 5,192,361
Total expenses	6,626,531	5,043,734
Increase (decrease) in unrestricted net assets	$ (21,573)	$ 148,627

NOTE H - ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE I - OBLIGATION TO TRANSFER FUNDS

The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 2002 and 2001 were $1,591,454 and $1,901,484, respectively.

NOTE J - LONG-TERM LIABILITIES

Long-term liabilities consist of the following:

	June 30, Current	Long-term	2002 Total	2001 Total
Prize liability Multi-State Lottery Association	$ -	$1,707,049	$1,707,049	$1,898,011
Accrued compensated absences	101,424	67,391	168,815	173,277
Note payable - Norwest Investment, interest rate 5.12% for 5 years requiring quarterly payments of $286,394.30.	1,054,786	1,109,836	2,164,622	3,167,088
	$1,156,210	$2,884,276	$4,040,486	$5,238,376

Notes to the Financial Statements Continued

Future scheduled principal maturities of the long-term note payable are as follows:

2003	$1,054,786
2004	1,109,836
2005 and beyond	0
Total	$2,164,622

NOTE K - LEASES

The Lottery leases its office, administrative and warehouse facilities under a non-cancelable lease agreement that is effective March 2002 through February 2007. Rent expense under operating leases charged to operations was $80,600 and $78,000 for the years ended June 30, 2002 and 2001, respectively.

The Lottery also has an operating lease for office equipment, primarily the photocopier, with monthly payments of $456, which expired August 2002. A separate maintenance agreement exists which follows the terms of the original lease. This agreement requires minimum payments of $95 per month or actual usage costs whichever is larger. Rental expenses for these leases consisted of $6,612 for each of the years ended June 30, 2001 and 2002.

Future minimum lease payments are $1,102 due in 2003 under operating leases that have remaining terms as of June 30, 2002.

NOTE L - EMPLOYEE BENEFIT PLANS

Pension Plan - The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Montana Public Employees Retirement Administration, P.O. Box 200131, 100 N. Park, Suite 220, Helena, MT 59620-0131, (406) 444-3154.

The contribution rate for the plan is required and determined by State law. The contribution rate for fiscal years 2002 and 2001, expressed as a percentage of covered payroll, was 6.9% for both years, for both the employer and the employees.

The amounts contributed to the plan during the years ended June 30, 2002 and 2001, were $137,503 and $134,636, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan - The Lottery's full-time regular employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts are deferred under the plan created under Internal Revenue Code Section 457 and Title 19, chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

NOTE M - RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 2002 and 2001, total payments to other State agencies were approximately $244,113 and $327,070, respectively.

NOTE N - COMMITMENTS AND CONTINGENCIES

Instant Tickets - The Lottery has an agreement with Oberthur Gaming Technologies Corp. to print instant game tickets. The contract expires August 8, 2008.

On-line Vendor - The Lottery is contracted with Scientific Games International to provide for the operation of an on-line gaming system through March 30, 2006. The estimated total contract price is approximately $24 million over the seven-year contract.

Advertising - The Lottery signed a contract with Banik & Associates to provide advertising services for $8,400 per month through December 2002.

Independent Observation of Drawings - The Lottery is committed to Galusha, Higgins and Galusha, PC, to observe *Montana Cash* and other special drawings. The term of the contract is for three years ending June 30, 2005. Compensation will not exceed $25,000 for the three year period.

Audit of Financial Statements - The Lottery is party to a contract with Galusha, Higgins and Galusha, PC, an independent accounting firm, to audit the Lottery's annual financial statements. The yearly contract was finalized on June 7, 1999, and is renewable annually for six years with the consent of all parties. Compensation for the year ended June 30, 2002 and 2001, will not exceed $11,500 and $11,500, respectively.

Prize Contingencies - Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of $1,203,676 and $1,456,765 at June 30, 2002 and 2001, respectively, if the insurance carrier defaulted on their payments.

NOTE O - RISK MANAGEMENT PUBLIC ENTITY RISK POOL

The Lottery contributes to the Group Employee Comprehensive Medical and Dental Plan and the Property and Casualty Insurance plans of the State of Montana. Details of these plans can be found in the State of Montana Comprehensive Annual Financial Report.

NOTE P - ADOPTION OF GASB NO. 34

The Lottery adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The adoption resulted in a change in the format and content of the basic financial statements as follows: contributed capital has been rolled into net assets and compensated absences has been divided into current and long-term portions. The change was effective for the year beginning July 1, 2001.

NOTE Q - RECLASSIFICATIONS

Certain accounts in the prior-year financial statements have been reclassified for comparative purposes to conform with the presentation in the current-year financial statements.

Independent Auditors' Report

on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 2002, and have issued our report thereon dated October 4, 2002. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Lottery's Commissioners, management and the Legislative Audit Committee and is not intended to be and should not be used by anyone other than those specified parties.

Galusha, Higgins & Galusha, PC

GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors
Helena, Montana

October 4, 2002

Montana Lottery
2525 North Montana Avenue
Helena, MT 59601
406-444-5825
www.montanalottery.com

Editor: Jo Berg
Graphic Design & Layout: Laurie Felch

Alternative accessible formats of this document will be provided upon request. Please make your request by calling 406-444-5825.

600 copies of this document were published at an estimated cost of $1.91 per copy, for a total of $1,143.